Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-304

CONTINENTAL CASUALTY COMPANY,

Petitioner,

v.

THE WINSTON CORPORATION,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

DWIGHT I. HURD
JOHN C. McDONALD
THOMAS W. HILL
Tingley, Hurd & Emens
250 East Broad Street
Columbus, Ohio 43215

Attorneys for Respondent,
The Winston Corporation

Washington, D.C. • CLB PUBLISHERS' • LAW PRINTING CO. • (202) 393-0625

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QUESTION PRESENTED

Whether this Court should review a narrow but proper interpretation of state law, where the Court of Appeals, applying the law of Georgia without bypassing or overriding any Georgia statutory or case law, properly held for Respondent on a question of contract interpretation which affects only the parties to this action in a decision which is of little or no importance beyond the confines of the unique facts of this action.

STATEMENT

This suit arises from the failure of Petitioner to honor its obligations on its performance and payment bond issued to guarantee the performance by Diversified Sales and Engineering, Inc. (the contractor) of a contract with Respondent to construct a nursing home in Atlanta, Georgia. The bond provided that Petitioner was firmly bound unto Respondent in the sum of $752,874 unless the contractor should "well and faithfully" perform the construction contract. (App. A, *infra*, p. 2a). A bond premium of $6,444 was paid by Respondent to Petitioner. (App. A, *infra*, p. 2a). Though the bond expressly incorporated all of the terms and provisions of the construction contract, Petitioner issued the bond without reading the construction contract and, in fact, never read it or even requested or obtained a copy of it until long after Petitioner had denied liability on the bond and this lawsuit had been commenced. (App. A, *infra*, p. 2a).

Before construction began, however, Petitioner discovered that the contractor was suffering severe financial difficulties. (App. A, *infra*, p. 2a). Petitioner later brought and won a suit against the contractor for non-performance of another construction contract. Yet, none of this was brought to Respondent's attention. (App. A, *infra*, pp. 2a, 3a).

Upon expiration of the contract period the building was far from finished despite Respondent's repeated exhortations. (App. A, *infra*, p. 3a). In January and in April, 1969, Respondent's officials met with the contractor in Atlanta to attempt to work out the problem. (App. A, *infra*, p. 3a). Although asked on

more than one occasion to attend these meetings, Continental refused and subsequent discovery revealed that over a year earlier the surety had secretly discussed denying the bond was still in force. (App. A, *infra*, p. 3a).

By early spring of 1969 Respondent faced a crisis. Its construction loan was about to mature; the permanent loan commitment was about to expire; no progress was being made on the project; and, despite requests therefor, no assistance was being given by Petitioner to resolve the problem. (App. A, *infra*, p. 3a). On April 7, 1969, Respondent and the contractor entered into a letter agreement designed to accelerate construction and minimize damages. (App. A, *infra*, p. 4a). The method chosen was an assignment by the contractor of his responsibilities and sub-contracts under the contract to Respondent. (App. A, *infra*, p. 4a). An assignment by either party was permitted under Article 33 of the construction contract. (App. A, *infra*, pp. 4a 6a). Under Article 33, neither Respondent nor the contractor was required to give any notice of the assignment to Petitioner. (App. A, *infra*, p. 6a). The assignment method was selected to preserve the existing subcontracts which had been entered into much earlier when construction costs were lower, thereby minimizing the damages to both Petitioner and Respondent.

Although Petitioner had refused to attend any meetings and even though the construction contract contained no notice requirement in case of assignment, Respondent, nevertheless, gave Petitioner immediate verbal notice (by telephone) of the assignment agreement on April 7, and on that day dispatched copies of the assignment agreement by mail to

Petitioner. Petitioner still did not respond. (App. A, *infra*, p. 4a). After completion of construction, Respondent submitted its claim on the bond to Petitioner, which was denied.

On these facts the District Court held that Petitioner could not recover on the bond, finding that (1) the April 7 agreement was a novation of the construction contract, which in the absence of consent, discharged the surety, and (2) the April 7 agreement was not an assignment but a termination under Article 22 of the contract and the failure of Respondent to give seven days notice under Article 22 released the surety. (App. B, *infra*).

In reversing the District Court, a unanimous Court of Appeals concluded that the April 7 agreement was intended as an assignment (App. A, *infra*, p. 4a), but held that whether the April 7 agreement was interpreted as an assignment (under Article 33) or as a termination (under Article 22) of the contract, it was merely an implementation of the express contract terms and therefore not a novation which would release the surety. (App. A, *infra*, pp. 6a, 7a).

Given its finding that the April 7 agreement was intended as an assignment under Article 33, which did not require notice to the surety, and which, because it was not a novation, did not release the surety, the Court of Appeals, in order to decide the case, did not have to proceed further on the seven day notice issue under the termination provision of the contract (Article 22). However, the Court addressed that issue, as well, noting that while there were no Georgia cases directly in point, the Georgia Supreme Court "has refused to give effect to unreasonable terms in surety contracts

and has applied equitable principles in order to achieve just results", citing *Waldon v. Maryland Casualty Co.*, 155 Ga. 76, 116 S.E. 828 (1923). (App. A, *infra*, p. 8a). After a thorough review of the rather limited Georgia case law on the issue, the Court of Appeals concluded that a "mere technical breach of a surety contract, not resulting in damage or prejudice to the surety, will not release it from its obligation" and that the Georgia Supreme Court would so hold in the instant case. (App. A, *infra*, p. 12a).

REASONS FOR DENIAL OF THE WRIT

Petitioner argues that this case has "practical aspects of great importance in the proper administration of the federal courts". There is no basis for this statement. The arguments of Petitioner pertain solely to the facts of this case and present no reasons (let alone compelling reasons) why this case has any significance beyond the parties to it. In truth, this case involves an interpretation of a unique set of contracts in a unique set of circumstances between two private parties. The likelihood of this kind of case arising again is simply too remote to warrant review by this Court. Moreover, the law upon which this case has been decided has seldom arisen in the courts of Georgia, and what law exists is, as the Court of Appeals pointed out, unsettled and often contradictory. The Georgia Supreme Court has never been presented with a case involving the application of *stricti juris* to a modern compensated bonding company. Indeed, that Court has dealt with the general novation-suretyship statutes only twice in

the last forty years and neither of these cases involved corporate sureties in the bonding business. *Alropa Corporation v. Snyder*, 182 Ga. 305, 185 S.E. 352 (1936); *Zellner v. Hall*, 86 S.E.2d 787 (Ga. 1954). Further, as can be seen from the briefs of the parties, in the last one hundred years, there have been only a handful of cases in the Georgia intermediate appellate courts involving Georgia suretyship law, and no cases involving the precise issues raised in the case at bar. The questions of state law involved in this case are clearly not of sufficient importance to merit review by this Court. The only real issues involved in this case turn on the particular facts of this case alone and are of interest only to the parties to it. Since, therefore, the decision of the Court of Appeals will have little or no impact outside the limits of this case, certiorari should be denied.

Moreover, as will be demonstrated below, even if certiorari were granted, this Court would utimately find that the Court of Appeals properly applied Georgia law and came to a fair and accurate decision based upon the specific facts of this case. For this reason also, certiorari should be denied.

A fair reading of the Court of Appeals opinion indicates that its decision was based on two alternative holdings. The first was that the April 7, 1969 agreement was intended as an assignment of the contract under Article 33, which rather than being a novation under Georgia law, was an implementation of the contract terms. Since Article 33 did not require notice to the surety of the assignment, there was no failure to comply strictly with the terms of Article 33, and Petitioner accordingly was not released from its bond. This portion of the decision by the Court of

Appeals is clearly one of contract interpretation, which should not be disturbed or reviewed by this Court. Moreover, the decision by the Court of Appeals on this point is supported by the Georgia appellate case of *Overcash v. First National Bank of Atlanta*, 115 Ga. App. 499, 155 S.E.2d 32 (1967), rehearing denied, 155 S.E.2d 32 (1967), cert. den. 155 S.E.2d 32 (1967), which held that a change in an assured contract which change is authorized by the contract itself does not release the surety. Petitioner has cited no cases to the contrary. Accordingly, the Court of Appeals properly applied the *Erie* doctrine on a matter of contract interpretation. *Erie Railroad v. Tompkins*, 304 U.S. 64 (1938).

The second, and alternative, holding of the Court of Appeals was that even if the April 7 agreement was a termination under Article 22, the failure to give the full seven days notice does not release the surety under Georgia law. Though this holding was accurate, it was not necessary. The case could have been decided solely on the first ground. In deciding the seven day notice issue, the Court of Appeals considered the question of whether *stricti juris* applies to compensated sureties under Georgia law. The Court of Appeals' treatment of this one issue constitutes the entire basis for Petitioner's objections to the Court of Appeals' decision. The Petitioner's only argument is based upon its allegation that the Court of Appeals improperly applied Georgia law in refusing to apply *stricti juris* to the notice provision of the construction contract. However, Petitioner fails to recognize that this issue was not the only basis for the Court's decision, and essentially can be seen as dictum. For this reason alone, certiorari should be denied.

A review of the Court's treatment of the seven day notice issue, however, will also reveal that the Court followed precisely the reasoning called for under the *Erie* doctrine and the Rules of Decision Act, and came to not only a well reasoned, but also a fair and accurate, conclusion as to how the Georgia Supreme Court would rule on that issue. *Erie Railroad v. Tompkins, supra;* 28 U.S.C. § 1652.

The Court of Appeals acknowledged that in deciding the seven day notice issue, it should apply the suretyship law of Georgia, as expressed by either its legislature or its highest court. *Erie Railroad v. Tompkins, supra.* The Court also noted, however, that in the absence of a dispositive statute or a controlling decision by the state's highest court, it was required to give proper regard to the relevant precedents of other courts of the state. *Commissioner v. Estate of Bosch,* 387 U.S. 456 (1967); *Bernhardt v. Polygraphic Co. of America,* 350 U.S. 198 (1956). The Court of Appeals then properly concluded that the Supreme Court of Georgia had never "definitively determined whether the distinction between compensated and uncompensated sureties applies in Georgia." (App. A, *infra,* p. 8a). This conclusion is supported by Petitioner's inability to cite any case in which the Georgia Supreme Court applied the rule of *strictí juris* to compensated sureties.

The Court of Appeals did, however, find one case in which the Supreme Court of Georgia refused to apply *stricti juris* to a compensated surety. *Waldon v. Maryland Casualty Co.,* 155 Ga. 76, 116 S.E. 808 (1923). In that case, the Georgia Supreme Court held that a non-material, non-detrimental variation from the contract did not release the defendant, a compensated surety, from the obligations of its bond. In view of the absence of a definitive holding, the *Waldon* case

constitutes the only evidence of how the Supreme Court of Georgia would probably rule in a case such as the one at bar. As aptly stated by the Court of Appeals, the *Waldon* case "evidences a policy of the Georgia Supreme Court to avoid an injustice that would result from giving effect to a technical breach of a contract of suretyship". (App. A, *infra,* p. 9a).

The Court of Appeals then reviewed relevant statutory provisions together with all applicable appellate court decisions as they apply to the seven day notice issue. The Court concluded that the novation statute was not intended to apply to compensated sureties, since the statutory definition of a "surety", as construed by the Georgia courts, excluded those who receive a separate consideration (e.g. a bond premium) for their undertaking.[1]

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[1] The Court properly cited *Wolkin v. National Acceptance Company,* 222 Ga. 487, 150 S.E.2d 831 (1966) for the proposition that the Supreme Court of Georgia would come to the same conclusion. *Wolkin, supra,* dealt with the *feme sole* statute in Georgia, which prohibits married women from binding their separate personal estates by a contract of suretyship. Both the *feme sole* statute and the "novation" statute utilize precisely the same definition of "contract of suretyship" found in 28A Georgia Code Ann. § 103-101. As stated by the 5th Circuit in *Fruehauf Corporation v. McIntire,* 408 F.2d 910 (5th Cir. 1969), the *Wolkin* case eliminates the confusion of prior Georgia cases on the definition of suretyship by making the receipt of consideration the determinative factor. See also, *Southern Land & Development Company, Inc. v. Silvers,* 499 F.2d 967 (6th Cir. 1974).

The Court went on, however, to examine whether any Georgia appellate cases had applied the statutory novation provision to compensated sureties. A review of the statute and the Georgia appellate cases led the Court to conclude that the "law of suretyship in Georgia is unsettled, and often contradictory". (App. A, *infra*, p. 11a). The Court was not alone in this observation, since, as the Court noted, many of the Georgia Courts of Appeals had come to the same conclusion. *General Finance Corporation of Atlanta, N.E. v. Welborn*, 98 Ga. App. 280, 105 S.E.2d 386 (1958); *Etheridge v. W.T. Rawleigh Co.*, 29 Ga. App. 698, 116 S.E. 903 (1923); *A.B. Small Co. v. Claxton*, 1 Ga. App. 83, 57 S.E. 977 (1907). Nevertheless, the Court accurately concluded that no court in Georgia had ever discharged a compensated surety because of a failure of its obligee to comply strictly with a provision of the assured agreement *unless* the departure from its terms increased the surety's risk or changed the contract to the surety's detriment. (App. A, *infra*, p. 11a).

Moreover, recent Georgia appellate cases have expressly stated that in order for the surety to be released the failure to comply strictly with terms of the agreement must be material and must either increase the surety's risk or operate to the surety's detriment. *Peachtree Roxboro Corp. v. United States Casualty Company*, 101 Ga. App. 340, 114 S.E.2d 49 (1960); *Farmer v. Peoples American Bank*, 132 Ga. App. 751, 209 S.E.2d 80 (1974), rehearing denied, 209 S.E.2d (1974); *Brunswick Nursing & Convalescent Center v. Great American Insurance Company*, 308 F.Supp. 297, 300 (S.D. Ga. 1970). In *Peachtree Roxboro v. United*

States Casualty, supra, the Georgia Court of Appeals was presented with the construction contract bond of a compensated surety who claimed release because of an alleged change in the method of making payments on the contract. The Court stated:

> "Even if the payment by the plaintiff of the guaranteed contract price before the payment to laborers and materialmen *was improper* (which is specifically denied), *the defendant casualty company is required to show that its risk was increased thereby in order to receive a discharge from its obligations under the bond.* A compensated surety is not a favorite of the law. A departure from the terms of a construction contract must be such as to *prejudice* a *paid surety* before it may be discharged." (emphasis added)

Likewise in the very recent case of *Farmer v. Peoples American Bank, supra*, the Georgia Court of Appeals refused to release a surety because there was no showing that the change in the contract increased the surety's risk or operated to the surety's detriment.

Georgia case law thus supports the conclusion by the Court of Appeals that the technical failure to give the full seven days notice to Petitioner, which neither increased Petitioner's risk nor operated to its detriment, did not release Petitioner from its bond. This conclusion was further buttressed by the recent decision of another federal court which interpreted Georgia surety law and had come to the same conclusion. *United States v. Algernon Blair*, 329 F.Supp. 1360 (D.S.C., 1971).

Thus, in applying the *Erie* doctrine, the Court of Appeals had before it (1) one case in which the Supreme Court of Georgia had applied equitable

principles and had expressly refused to release a compensated surety because of a non-material variation in the contract which neither operated to the surety's detriment or increased its risk, *Waldon v. Maryland Casualty Co., supra;* (2) no Georgia Supreme Court case which released a compensated surety because of a change in the assured contract which neither operated to its detriment or increased its risk; (3) one Georgia appellate case which unequivocally stated that *stricti juris* does not apply to compensated sureties, and that a compensated surety will not be released unless the change operates to the surety's detriment or increases its risk, *Peachtree Roxboro v. United States Casualty, supra;* (4) one federal district court case in Georgia which clearly stated that the change in the contract must be material before the surety is released, *Brunswick Nursing & Convalescent Center v. Great American Insurance Company, supra;* and (5) one other federal court case which interpreted Georgia law consistently with the Court of Appeals' interpretation, *United States v. Algernon Blair, supra.* In the face of these precedents the Court of Appeals was perfectly within the ambit of the *Erie* doctrine in concluding that the Georgia Supreme Court would not apply *stricti juris* to the facts of this case and would find that the non-material, non-detrimental failure to give the full seven days notice would not operate to release the surety, *even if* the April 7 agreement were a termination under Article 22 of the Construction Contract. Equally important for this Court's consideration is the fact that the Court of Appeals' decision is subtantiated by the most recently reported decision from the Georgia Court of Appeals. *Farmer v. Peoples American Bank, supra.* Under these circumstances, this

Court should adhere to its longstanding policy of accepting the Court of Appeals determination of state law, especially where reasonable arguments can be either way on that point of law. *General Box Company v. United States,* 351 U.S. 159 (1956); *Spiegel's Estate v. Commissioner,* 335 U.S. 701, 708 (1949), rehearing denied, 336 U.S. 915 (1949); *Ragan v. Merchants Transfer & Warehouse Co., Inc.,* 337 U.S. 530, 534 (1949); *Huddleston v. Dwyer,* 322 U.S. 232, 237 (1944).

CONCLUSION

The instant case should not be accepted by this Court since it does not involve an important question, either of law or of administration of the federal courts. Since the Court of Appeals' properly applied the *Erie* doctrine and the Rules of Decision Act, no useful purpose would be served by issuance of the writ. Certiorari should, accordingly, be denied.

DWIGHT I. HURD
JOHN C. McDONALD
THOMAS W. HILL
Tingley, Hurd & Emens
250 East Broad Street
Columbus, Ohio 43215

Attorneys for Respondent
The Winston Corporation

September, 1975

APPENDIX A

No. 73-1886

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

THE WINSTON CORPORATION,
Plaintiff-Appellant,

v.

CONTINENTAL CASUALTY COMPANY,
Defendant-Appellee.

ON APPEAL from the United States District Court for the Southern District of Ohio, Eastern Division.

Decided and Filed January 17, 1975.

Before: WEICK and MCCREE, Circuit Judges, and CONTIE,* District Judge.

MCCREE, Circuit Judge. This is an appeal from a judgment in a diversity action for defendant-appellee on a performance and payment bond executed by Continental Casualty Company, as surety, in favor of appellant, The Winston Corporation, as obligee. The parties agree that Georgia law applies.

The facts of the case are virtually undisputed. In 1967, Diversified Engineering and Sales Corporation (Diversified) agreed to build for The Winston Corporation (Winston) a nursing home at a cost of $752,874.00. The construction contract required Diversified to obtain a performance and payment bond from an acceptable bonding company. Diversified purchased a bond from Continental Casualty Company (Continental) for a premium of $6,444.00. A copy of the bond, drafted by Continental on its own printed form, was delivered to Winston on October 3, 1967.

* The Honorable Leroy J. Contie, Jr., Judge, United States District Court for the Northern District of Ohio, sitting by designation.

The bond expressly incorporated the provisions and specifications of the construction contract and provided, *inter alia*:

> NOW, THEREFORE, THE CONDITION OF THE ABOVE OBLIGATION IS SUCH, that if the above bounden Principal shall well and faithfully perform the things agreed by him to be performed, according to the terms, conditions, and requirements of the foregoing contract; and shall pay all persons who have furnished labor or material for use in or about the improvement; and shall indemnify and save harmless the Obligee, and its officers, agents and employees, from any and all claims for damages, costs, judgments, and other expenses, arising or growing out of this contract; then, this obligation shall be null and void, otherwise, the same shall remain in full force and effect.

Continental issued the bond without reading the construction contract and never even requested a copy of it until approximately two and one-half years later. Continental did, however, investigate the financial condition of Diversified and its principal before it issued the bond. It learned that Diversified had comparatively thin assets, a not uncommon condition for some construction companies, but that Diversified's principal was financially stable. Before construction began several weeks later, however, Continental discovered that Diversified's principal was suffering a serious financial setback and that he would no longer be participating in the project. Continental did not object to his withdrawal, and accepted another officer of Diversified as a substitute, even though he had submitted to Continental financial statements overstating his own and Diversified's net worth.

Continental never communicated any of this unfavorable financial information to Winston.

On December 4, 1967, Winston obtained a construction loan for which it executed a $1,250,000.00 promissory note and security deed. On December 11, the construction lender, the permanent lender, and Winston agreed that the permanent lender would purchase the loan from the construction lender upon completion of the project.

On the next day, Winston instructed Diversified to begin construction in accordance with their contract which provided that the project be completed within 300 calendar days after commencement of construction.

Shortly thereafter, construction began with completion scheduled for mid-October 1968. Upon expiration of the 300 day period, however, the building was far from finished despite Winston's repeated exhortations. Continental watched closely the developments at the construction site and was fully aware of the construction delays and problems. In addition, Continental had initiated a lawsuit against Diversified in that same year for non-performance of another construction contract and eventually obtained a favorable judgment.

After the scheduled completion date had passed, Winston officials met with Diversified in January and again in April 1969. In April, the project was still not finished even though more than five months had elapsed since the scheduled completion date. Continental was asked on more than one occasion to attend these meetings convened to resolve construction delays and problems. The surety, however, refused to attend. During discovery proceedings, Winston learned that Continental, as early as April 1968, shortly after construction had begun, had discussed denying that the bond was still in force. These discussions were not communicated to Winston.

In early spring of 1969, Winston faced the following crisis: the construction loan was about to mature; the permanent loan commitment was about to expire; and no progress was being

made on the project. Accordingly, on April 7, 1969, after an earlier meeting to which Continental had been invited but refused to attend, Winston and Diversified entered into a letter agreement designed to accelerate construction. This agreement, intended as an assignment of the construction contract, permitted Winston to take possession of the premises, to assume construction of the project, and to take an assignment of Diversified's subcontracts and other rights. It specifically contemplated, however, Diversified's continuing participation in the contract. Moreover, one of its provisions stated that the agreement "does not modify or change the existing bond on the project which exists for the owner's benefit." The agreement, considered to be the most efficacious method of completing construction at the lowest cost and with the least delay, was believed to be authorized by Contract Article 33 governing assignment.

On the same day, April 7, 1969, Diversified notified Continental by telephone of the letter agreement and mailed a copy of it. Within a few days, Winston took over construction of the nursing home, and it was completed in mid-October 1969, approximately twelve months after the scheduled completion date. Winston took possession of the premises and began nursing operations a month later.

In December 1969, Winston submitted a claim to Continental on the performance and payment bond. When Continental refused to honor the bond, Winston brought this action in United States District Court on June 18, 1970.

The amended complaint alleged that the performance and payment bond had been executed by Continental to guarantee performance of the construction contract between Winston and Diversified; that the construction contract required Diversified to furnish all labor and materials for the construction of a nursing home in Georgia in accordance with certain plans and specifications; that Diversified had failed

to do so; and that Continental had failed to honor the bond it issued in connection with the project. It also alleged that Continental had acted tortiously toward Winston by failing to relay to Winston information it learned concerning Diversified's precarious financial condition.

In 1972, the case was tried before the district court sitting without a jury. Its decision was issued on March 2, 1973, and judgment was entered in favor of Continental. After a motion for reconsideration was denied, notice of appeal was filed on June 19, 1973.

In its opinion, the district court determined that Winston could not recover on the performance and payment bond because (1) the April 7 agreement was a novation of the construction contract that had the effect of discharging the surety in the absence of the surety's consent; and (2) the failure of Winston to give Continental seven days written notice under Article 22 before terminating the employment of the contractor released Continental from its obligations on the bond. In addition, the court determined that Winston could not recover damages on either a common law tort or contract theory.

On appeal, Winston contends that the district court erred in concluding that the April 1969 agreement was a novation that discharged Continental, and argues further that if it were a novation, Continental consented to it in advance and therefore is not discharged. It also argues that even if it were a novation to which Continental did not consent, Continental, as a compensated surety, is not discharged because the novation was not actually detrimental to its interests. Further, Winston contends that the district court erred in denying recovery to it because of failure to comply strictly with the notice provisions of Article 22 of the construction contract. Finally, it contends that the district court erred in holding that Winston did not have a valid claim against Continental on common law tort and contract theories.

An examination of the opinion filed by the district court, of the briefs and record filed in connection with the appeal, and of Georgia law, convinces us that whether the April 7 agreement is interpreted as an assignment or as a termination of the contract, it did not discharge the surety. We also determine that the failure of Winston to comply strictly with the notice provisions of Article 22 did not excuse Continental from its undertaking to indemnify Winston under the bond. Accordingly, we need not decide the other assignment of error.

Under Georgia law, a material change in the terms of a contract is considered a novation and discharges a surety. *Brunswick Nursing & Convalescent Center, Inc.* v. *Great American Insurance Co.*, 308 F.Supp. 297, 299-300 (S.D. Ga. 1970); *American Surety Co. of New York* v. *Garber*, 114 Ga. App. 532, 151 S.E.2d 887 (1966).

In this case, the construction contract, which was expressly incorporated in the bond, permitted both an assignment[1] of the contract and its termination under specified circumstances. Article 22, "OWNER'S RIGHT TO TERMINATE CONTRACT," provided, in relevant part,

> If the Contractor should . . . persistently or repeatedly refuse or should fail, except in cases for which extension of time is provided, to supply enough properly skilled workmen or proper materials, . . . or otherwise be guilty of a substantial violation of any provision of the Contract, then the Owner . . . may, without prejudice to any other right or remedy and after giving the Contractor, and his surety, if any, seven days written notice, terminate the employment of the Contractor and take possession of the premises and of all materials,

[1] The assignment article of the contract provides:
ASSIGNMENT
Neither party to the Contract shall assign the Contract or sublet it as a whole without the written consent of the other, nor shall the Contractor assign any moneys due or to become due to him hereunder, without the previous written consent of the Owner.

tools and appliances thereon and finish the work by whatever method he may deem expedient.

By the very terms of the contract to which Continental agreed, Winston had an absolute right to terminate the employment of the contractor and to assume the construction of the home itself. Accordingly, even if the April 7 agreement be considered a termination of the contract, it was not a novation since it was contemplated by the terms of the contract. Instead, it was an implementation of one of the contract provisions. Winston, by the April 7 agreement, merely undertook to do that which Diversified had promised, but failed to do.

The next question is whether Continental was discharged from its ob'igation because Winston failed to give it written notice seven days in advance of taking over the construction. In deciding this question, we apply the surety law of the State of Georgia as expressed either by its legislature or by its highest court. *Erie Railroad* v. *Tompkins*, 304 U.S. 64 (1938). And, in the absence of a dispositive statute or a controlling decision by the state's highest court, we apply what we determine to be the state law after giving proper regard to relevant precedents of other courts of the state. *Commissioner* v. *Estate of Bosch*, 387 U.S. 456 (1967).

Historically, an alteration of the primary obligation owed to the obligee discharged the surety. *Bethune* v. *Dozier*, 10 Ga. 235, 238-39 (1851), 10 Williston, *Contracts*, § 1240 (rev. ed. 1917). The obligation of a surety was considered *stricti juris*, and even a slight deviation from the contract terms discharged the surety. The results of applying this rule were often harsh and unjust, especially when compensated sureties were relieved of their obligations because of technical breaches of the assured contract. Consequently, most courts departed from the rule of *stricti juris* in cases in which a surety had been compensated for its undertaking and developed the rule that a compensated surety is discharged only if the change is material and causes some injury, loss,

or prejudice to it. *See Montpelier* v. *National Surety Co.*, 97 Vt. 111, 122 A. 484, 33 A.L.R. 489 (1923), *School District* v. *Massachusetts Bonding & Ins. Co.*, 92 Kan. 53, 142 P. 1077 (1914), *Bross* v. *McNicholas*, 66 Or. 42, 133 P. 782 (1913), Annot., 127 A.L.R. 10, 62-63 (1940), Annot., 12 A.L.R. 382 (1921), Note, 33 Tulane L. Rev. 717 (1959).

Although most jurisdictions now differentiate between compensated and uncompensated sureties for the purpose of determining contractual liability, there is recent authority in Georgia that appears to support the application of the *stricti juris* rule even when the surety is compensated. *Brunswick Nursing & Convalescent Center, Inc.* v. *Great American Surety Co., supra*, *Peara* v. *Atlanta Newspapers, Inc.*, 120 Ga. App. 163, 169 S.E.2d 670 (1969).

The Georgia Supreme Court has not, however, definitively determined whether the distinction between compensated and uncompensated sureties applies in Georgia. Appellant has cited only two cases decided by the Supreme Court of Georgia in which the question of discharge of a surety has been discussed, and appellee has cited none. Neither case is dispositive. *Zellner* v. *Hall*, 210 Ga. 504, 80 S.E.2d 787 (1954) and *Alropa Corp.* v. *Snyder*, 182 Ga. 305, 185 S.E. 352 (1936) stand only for the proposition that a surety is discharged by an act of his principal or obligee that increases its risk unless it consents to the novation. They do not hold that a compensated surety is discharged by a change in the contract that does not increase the risk it has assumed.

In other instances, although the Georgia Supreme Court has spoken in terms of *stricti juris* in considering the liability of sureties, it has refused to give effect to unreasonable terms in surety contracts and has applied equitable principles in order to achieve just results. Thus, in *Waldon* v. *Maryland Casualty Co.*, 155 Ga. 76, 116 S.E. 828 (1923), the court considered the effect of the failure of the obligee to comply strictly with contract provisions for service of process on the

surety in an action on the bond. The pertinent portion of the contract stated:

> Provided, however, that this bond is executed upon the following express conditions, the performance of each of which shall be condition precedent to any right of recovery hereon, anything in the contract to the contrary notwithstanding . . . 2. That no claim, suit, or action by reason of any default shall be brought against the principal or surety after the 18th day of March, 1916, nor shall recovery be had for damages accruing after that date; that service of writ or process commencing any such suit or action shall be made on or before such date . . . .

155 Ga. at 80. Service of process on the surety was not perfected until March 30, 1916, although the suit was filed before March 18. The court refused to construe the contract terms strictly and held that service on the surety company related back to the filing of the suit. It held that any other interpretation of the contract would empower court officers to prevent recovery by delaying service of process. Because the contract in *Waldon* stated that service of process before a certain date was a condition precedent to the surety's liability, the court's decision to hold the surety liable when the action was timely commenced evidences a policy of the Georgia Supreme Court to avoid an injustice that would result from giving effect to a technical breach of a contract of suretyship. And the Georgia Supreme Court applied equitable principles in an action against a surety who was not permitted to claim the rule of *stricti juris* when his own actions contributed to the default. *Jones* v. *Hawkins*, 60 Ga. 52 (1878).[2]

[2] In this case an attorney had acted as surety for his client and procured a discharge in bankruptcy. The attorney asserted that the bankruptcy adversely affected the risk he undertook. The court held: "Whilst there is nothing immoral in what [surety] did as counsel, yet he does not come into court in such manner as entitles him to claim *stricti juris* as his measure of right." 60 Ga. at 56.

Since *Erie* directs our attention to the statutes of the state as well as its high court decisions, we consider 28A Georgia Code Annotated, section 103-202, which provides:

> Any change in the nature or terms of a contract is called a novation; such novation, without the consent of the surety, discharges him.

It is evident, however, that the Georgia legislature intended the sweeping provisions protecting sureties to apply only to uncompensated sureties. The very first section of the surety statute defines a contract of suretyship as

> . . . one whereby a person obligates himself to pay the debt of another in consideration of credit or indulgence, or other benefit given to his principal, the principal remaining bound therefor. It differs from a guaranty in this, that the consideration of the latter is a benefit flowing to the guarantor.

28A Ga. Code Ann. § 103-101.

The plain meaning of this section is that only uncompensated sureties were intended to benefit from this statutory protection and compensated sureties were to be treated as guarantors.

The statute has been so applied in cases where married women seek to bind their separate estates to secure the extension of credit to third persons. In Georgia, married women may not act as sureties and bind their separate estates but may act as guarantors. The determinative factor in deciding whether a married woman has agreed to act as a surety or as a guarantor is whether she has received "new, separate and independent" consideration for the undertaking. If she did not, she is a surety, for the purpose of the statute, and her separate estate is not bound by her undertaking. *See, e.g., Southern Land & Development Co.* v. *Silvers*, 499 F.2d 967 (6th Cir. 1974), *Wolkin* v. *National Acceptance Co.*, 222 Ga. 487, 150 S.E.2d 831 (1966). Never-

theless, a third person, not a married woman, who obligates himself to pay the seller of goods in consideration of credit extended to a purchaser has, in Georgia, uniformly been considered a guarantor even through he receives no independent consideration.

In cases other than those concerning the power of married women to bind their separate estates and concerning the extension of credit to the purchaser of goods, the line of demarcation between sureties, who are said to be favorites of the law, and guarantors, who are said not to be, is not clear despite the statutory definition of those terms. However, we observe that in none of the cases cited by the parties has a compensated surety been discharged because of the failure of its obligee to comply strictly with a provision of the assured agreement unless the departure from its terms increased the surety's risk or changed the contract to the surety's detriment. *See, e.g., Alropa Corp.* v. *Snyder, supra, Hill* v. *O'Neill*, 101 Ga. 832, 28 S.E. 996 (Ga. 1897), *Peara* v. *Atlanta Newspapers, Inc., supra, Palmes* v. *Southern Mechanical Co.*, 117 Ga. App. 672, 161 S.E.2d 413 (1968), *Mayor & Aldermen of the City of Savannah* v. *Glen Falls Insurance Co.*, 104 Ga. App. 879, 123 S.E.2d 293 (1961), *cf. American Surety Co. of New York* v. *Garber*, 114 Ga. App. 532, 151 S.E.2d 887 (1966).

From our review of the statutes and case law, we conclude, as many of the Georgia courts of appeals have, that the law of suretyship in Georgia is unsettled, and often contradictory. *E. g., General Finance Corp. of Atlanta, Northeast* v. *Welborn*, 98 Ga. App. 280, 105 S.E.2d 386 (1958), *Etheridge* v. *W. T. Rawleigh Co.*, 29 Ga. App. 698, 116 S.E. 903 (1923), *A. B. Small Co.* v. *Claxton*, 1 Ga. App. 83, 57 S.E. 977 (1907). Since there is no authoritative expression of Georgia law, we may exercise our judgment based upon applicable principles of state law, upon relevant decisions in other jurisdictions, and upon our own conceptions of sound and just rules. *E. g., Putnam* v. *Erie City Manufacturing Co.*,

338 F.2d 911 (5th Cir. 1964), *New England Mutual Life Insurance Co.* v. *Mitchell*, 118 F.2d 414 (4th Cir.) *cert. denied*, 314 U.S. 629 (1941).

We believe that the Georgia Supreme Court, if it were deciding this case, would follow recent authority and refuse to apply the outmoded *stricti juris* rule that some Georgia courts have stated is applicable to compensated sureties. Instead, we believe the supreme court would determine that appellant's failure to give seven days notice was an insubstantial breach in light of the circumstances of this case, and that it caused no prejudice or injury to the surety.

Under modern American surety law, a mere technical breach of a surety contract, not resulting in damage or prejudice to the surety, will not release it from its obligations.[3] *Montpelier* v. *National Surety Co.*, 97 Vt. 111, 122 A. 484, 33 A.L.R. 489 (1923), *Doyle* v. *Faust*, 187 Mich. 108, 153 N.W. 725 (1915), *School District* v. *Massachusetts Bonding & Ins. Co.*, 92 Kan. 53, 142 P. 1077 (1914), *Bross* v. *Mc-Nicholas*, 66 Or. 42, 133 P. 782 (1913), Annot., 127 A.L.R. 10, 62-63 (1940), Annot., 12 A.L.R. 382 (1921), Simpson, *Suretyship* 111 (1950). This is the situation here. In the bond it executed for the benefit of Winston, Continental agreed, for a substantial consideration, that the bond would "remain in full force and effect" until the principal, Diversified,

> shall well and faithfully perform the things agreed by him to be performed, according to the terms, condi-

[3] We observe here that Louisiana has surety statutes similar to those of Georgia, and Louisiana courts have given literal effect to the statutes' terms. Art. 2198 of the Louisiana Civil Code provides that "the novation that takes place with regard to the principal debtor discharges the surety," and is similar to section 103-202 of the Georgia Code. Art. 3061 of the Louisiana Civil Code provides that any act of the obligee which is prejudicial to the rights of the surety discharges it. This provision is similar to section 103-203 of the Georgia Code. Originally, Louisiana courts made no distinction between accommodation sureties and compensated sureties, but a more realistic approach was taken in *Texas & Pacific R.R.* v. *United States Fiduciary & Guaranty Co.*, 16 So.2d 671 (La. App. 1944), where strict construction of surety contracts was limited to accommodation sureties.

> tions, and requirements of the foregoing contract; and shall indemnify and save harmless the Obligee, and its officers, agents and employees, from any and all claims for damages, costs, judgments, and other expenses, arising or growing out of this contract . . . .

Moreover, when Continental executed the bond, or shortly thereafter, it was aware of the precarious financial condition of Diversified and of its failure to perform another construction contract to which Continental had acted as surety. Continental kept itself informed of the progress of construction of the nursing home and was aware of the delays and difficulties that finally led to the April 7 agreement. Continental was invited to discuss construction problems with Diversified and Winston several times but declined to attend any meeting including the one on April 7.

Had the April 7 agreement provided that it would not become effective until seven days after receipt by Continental, there is no doubt that Continental would not have been discharged. We do not believe that this insignificant distinction, in light of Continental's knowledge of the construction problems and its rejection of Winston's repeated invitations to discuss them, should require a different result.

Reversed and remanded for entry of judgment for appellant.

APPENDIX B

IN THE
DISTRICT COURT OF THE UNITED STATES
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

FILED
JOHN D. LYTER, CLERK

U.S. DISTRICT COURT
SOUTHERN DIST. OHIO
EAST. DIV. COLUMBUS

THE WINSTON CORPORATION,
Plaintiff

v. Civil No. 70-179

CONTINENTAL CASUALTY
COMPANY,
Defendant

OPINION AND ORDER

The Winston Corporation, an Ohio corporation, brings this action against Continental Casualty Company, a company organized under the laws of Illinois, on a performance and payment bond issued by Continental as surety for Diversified Engineering and Sales Corporation. The Court's diversity jurisdiction has been properly invoked under 28 U.S.C. §1332 and the

amount in controversy exceeds $10.000.00. The parties are in agreement that the law of Georgia will control the decision of this Court. This matter has now been submitted following trial to the Court, on the evidence, exhibits, stipulations and briefs of the parties.

This suit emerges from Winston's efforts to construct, between 1967 and 1969, the King's Inn Nursing Home in Atlanta, Georgia. While Winston and several of its principal officers had some experience in the construction field, primarily in residential housing, the decision to construct this nursing home represented a major and novel commitment of the corporation's resources. By the end of the summer of 1967, it had tentatively arranged for construction loans and commitments from banks in Atlanta, Georgia, and Rochester, New York. Bids were then let and three general contractors including Diversified Engineering and Sales Corporation of Atlanta, Georgia, bid on the project. The three bids came in at approximately $900,000.00 but after further negotiations, Winston entered into a contract with Diversified dated October 3, 1967, whereby Diversified agreed to build the nursing home for $752,874.00 in accordance with plans, specifications and subcontracts attached to that document. The term of the contract provided for completion of the structure within three hundred (300) days from the time construction commenced.

As a further condition to the contract of October 3, 1967, Diversified agreed to supply a performance and payment bond for the benefit of Winston as obligee. This bond was executed on October 3, 1967, between Diversified, as principal, and Continental, as surety, and by its express terms incorporated the provisions and

specifications of the contract of the same date.[1] Before it authorized the bonding of the nursing home project, Continental investigated the financial condition of Diversified and its principals, David W. Knight and Vance Dyer. This investigation revealed that while Diversified's assets, like those of many construction companies, were comparatively thin, its principal Knight appeared quite substantial and on this basis Continental accepted the risk of bonding the project.

Prior to the commencement of construction in January, 1968, Continental discovered that Knight was suffering financial ruin and would no longer be participating in the construction of the nursing home. Continental did not object in any form to Knight's withdrawal from the project and accepted Dyer as chief officer of Diversified in his place. It made no effort, however, to inform Winston of the data it had uncovered during its prebonding investigations, which revealed the less than solid financial condition of both Diversified and Dyer. Neither did Continental disclose to Winston that Diversified and Dyer had submitted

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[1] The obligations of Continental under the bond of October 3, 1967, were as follows:

> "... [I]f the above bounden principal [Diversified] shall well and faithfully perform the things agreed ... to be performed, according to the terms, conditions, and requirements of the foregoing contract; and shall pay all persons who have furnished labor or material for use in or about the improvement; and shall indemnify and save harmless the obligee [Winston] ... from any and all claims for damages, costs, judgments, and other expenses, arising or growing out of this contract; then, this obligation [in the amount of $752,874.00] shall be null and void, otherwise, the same shall remain in full force and effect."

financial reports which overstated their actual net worth. Continental did not, at any time, suggest that Knight's departure from the project altered their obligations under the bond of October 3, 1967.

Construction work on the nursing home finally commenced in January of 1968 and proceeded disastrously almost from the outset. Under pressure from the municipal authorities, Diversified found it necessary to move the entire site of the project ten feet from where it had expected to build it; and problems having to do with the foundation of the nursing home were also encountered. By the late spring and summer of 1968 it became obvious to everyone connected with the project that construction of the nursing home had fallen hopelessly behind schedule. Despite increased exhortations from Winston and its agents, Diversified was unable to maintain a construction pace reasonably calculated to yield a completed structure at the expiration of the 300-day term. In August, 1968, for example, 70% of the term had elapsed but the structure was only 28% completed. A new certifying architect was brought in at that time in an effort to impose firmer control on the course of the construction.

By the summer of 1968 it had also become obvious to all interested observers that there was little correlation between the percentage of completed structure and the percentage of depleted construction funds. In the middle of September, 1968, for example, approximately one-third of the building was completed but approximately one-half of the contract price had been expended for that portion of the construction.

Continental followed developments at the construction site closely and its agents prepared a

continuous stream of memoranda about the position the company should take were a claim filed under the bond. Some of Continental's agents were of the opinion that the bond was not in legal force because of Winston's alleged failures to abide by Article 8.3 of the contract; others argued in memos to the home office that Continental was discharged from its obligations because of a change made in the manner of disbursements in January, 1968, by the lending bank in Atlanta. There is no evidence, however, that Continental firmly decided on a legal course of action prior to the time that a claim was actually made upon the bond in December, 1969.

The 300-day term of the contract expired by November, 1968. Winston, in an effort to clarify its exposure, called for a meeting of the three parties to the surety contract in January, 1969. The company was concerned, as its deadline for closing the permanent loan was April 1, 1969, and because it had already entered into a lease with River City Corporation for the completed nursing home. Continental declined to attend this meeting, indicating somewhat cryptically that it would proceed in accordance with its obligations under the bond. The surety refused, however, to give Winston any opinion on the effect further delay in the construction of the nursing home would have on the continued validity of the bond.

Events reached their climax in April, 1969, with Winston bringing things to a head. It requested a meeting among the three parties in Atlanta, but Continental refused to attend. After negotiations on April 3, 1969, Winston decided to terminate, pursuant to Article 22 of the General Conditions of the

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Contract.[2] Diversified's participation in the construction of the nursing home. Diversified reacted to this move by threatening legal action and after further negotiations the parties entered into an agreement dated April 7, 1969. By its terms Diversified was relieved of further responsibility towards the construction of the King's Inn Nursing Home. All of its contracts with the project's subcontractors were assigned to Winston, which took over day by day responsibility for the construction. While the documents drafted by Winston and Diversified do not directly state that the contractor was in default under the contract, the agreement of April 7th constituted the functional equivalent of a declaration of default. Although Winston vigorously denied that this was the intent of the parties, the effect of these negotiations leads inescapably to our present conclusion. It is undisputed that Continental was not

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[2] Article 22, of the Contract, provides in material part as follows:

> "*Owner's Right to Terminate Contract* – If the Contractor should be adjudged a bankrupt, . . . or if he should fail to make prompt payment to subcontractors or for material or labor, or persistently disregards laws, ordinances or the instructions of the Architect, or otherwise be guilty of a substantial violation of any provision of the Contract, then the owner, upon the certificate of the Architect that sufficient cause exists to justify such action, may, without prejudice to any other right or remedy and after giving the Contractor, and his surety, if any, seven days written notice, terminate the employment of the Contractor and take possession of the premises and of all materials, tools and appliances thereon and finish the work by whatever method he may deem expedient . . . ."

given the seven days written notice of plaintiff's intent to default Diversified as was required by Article 22.

With Winston in direct charge of the project, things began to proceed more smoothly. An extension of the bank loans was negotiated and while the original lease for the nursing home was terminated, a new one, albeit at less favorable terms, was entered into. Under Winston's control the nursing home project was completed on October 24, 1969, at a total cost of $1,018,000.00. After Continental refused, in December, 1969, to recognize any liability under the bond, Winston brought the present action to recover actual damages in the amount of approximately $619,000.00 plus interest. This amount represents the additional construction costs over and above the contract price; increased interest on the extension of the permanent loan and the construction loan; and the loss of rental income due to Winston's inability to perform on its lease with River City Corporation. In addition, Winston is seeking to recover punitive damages against Continental for its alleged failure to comply in good faith with the terms of the bond and for the surety's failure to make financial information concerning Diversified available to Winston.

On the state of facts as set forth above, this Court is of the opinion that judgment must be entered in favor of the surety. Our holding is based on two primary grounds: that the agreement entered into between Winston and Diversified on April 7, 1969 constituted a novation of the original contract which, under principles of Georgia law, discharged the surety; and on the further ground that Winston failed to abide by the notice provisions of Article 22 of the Contract, see n.2

supra. We believe that certain other contentions advanced by the parties are without legal merit.[3] These legal conclusions will be discussed in more detail below.

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[3] For example, the contract between Winston and Diversified contained a provision which required the consummation of financing arrangements within sixty (60) days from the signing of the contract and provided for notice of this fact to Diversified. This was set out in Article 23 of that document, which further provided that:

> This contract is conditioned upon the consummation of the loan financing of construction cost by the owner with the Fulton National Bank of Atlanta and the consummation of the permanent financing by the owner with First Federal Savings and Loan Association of Rochester, New York, and upon the consummation of said financing the owner will notify the contractor by letter addressed to the contractor at 3390 Peachtree Road, N.E. Suite 1544 by registered mail and upon receipt of said letter this condition shall be satisfied and no longer effective but in the event the said letter is not received by the contractor within sixty (60) days from date, this contract shall become null and void.

In fact, permanent financing was not solidified until late December, 1967, beyond the 60-day provision of that Article, 8.3.

Continental, the surety herein, argues that this delay beyond the term specified in Article 23 resulted in the voiding of the entire contract. We note, however, that while this particular term of the contract was not followed, neither Winston, Diversified, nor Continental raised any objection at the time this alleged breach occurred, or sought then to invalidate the entire contract. A bond premium, in the sum of $6,444.00 was paid to Continental's agent on or about January 26, 1968, beyond the 60-day term, and all parties proceeded thereafter in accordance with the other terms of the contract. These acts of the surety constitute a legal waiver of the term provision of Article 23 of the contract and we therefore do not think that this contention of Continental's is well taken.

In the past many Georgia courts followed the rule that a compensated surety was not a favorite of the law and had to show that a novation was detrimental to it before being entitled to a discharge. See *Peachtree Roxboro Corp. v. United States Casualty Co.*, 101 Ga.App. 340, 114 S.E.2d 49, 53 (1960); also see *United States v. Algernon Blair, Inc.*, 329 F.Supp. 1360 (D. S.C. 1971) (under Georgia and South Carolina law). This rule is similar to the view taken by the Restatement, see *Restatement of* Security, Sec. 128(b) and by the courts of Ohio, see *Indemnity Co. v. Granite Co.*, 100 Ohio St. 373 (1919); *American Guarantee Co. v. Cliff Wood Coal & Supply Co.*, 115 Ohio St. 524 (1926); *Carter v. Bernard*, 269 N.E.2d 139 (C.P. Montgomery Cty. 1971).

The present majority rule in Georgia, however, is now to the contrary. The controlling case law in that state, now codified in the Georgia Code, provides that "any change in the terms of the contract is considered a novation and discharges the surety in the absence of the latter's consent. The surety is also discharged by any act of the creditor which injures him or increases his risk. Ga. Code Annot. 103-202, 103-203."[4]

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[4] Sections 103-202 and 103-203 of the Georgia Code Annotated, which are the basis of the holding in the *Brunswick* case, provide, in material parts, as follows:

> Section 103-202 – "[a]ny change in the nature or terms of a contract is called a novation; such novation, without the consent of the surety, discharges him.
>
> Section 103-203 – "[a]ny act of the creditor . . . which injures the surety or increases his risk, or exposes him to a greater liability, shall discharge him . . ."

Brunswick Nursing & Construction Center, Inc. v. Great American Insurance Company, 308 F.Supp. 297 (S.D. Ga. 1970). Under this view a surety need not show that he was injured by the novation, see *Alropa Corporation v. Snyder*, 182 Ga. 305, 185 S.E. 352, a novation for these purposes being defined as "a change in the nature and terms of the contract," see *American Surety Company of New York v. Garber*, 114 Ga. App. 532, 151 S.E.2d 887 (1966).

Under these principles, it is plain that the April 7th revision of the contract constituted a novation within the meaning of Georgia law. Diversified's role in the construction of King's Inn was effectively ended by this novation and Winston entered, for the first time, into direct contractual relationships with the project's subcontractors. The contract of April 7th, therefore, has little relationship to the contract between Winston and Diversified as originally bonded by Continental. It cannot be maintained, as plaintiff attempts to do, that these changes were not material alterations or that they were permitted by the "addendums, modifications and amendments" clause of the bond. On the contrary, the agreement of April 7th entirely changed the operative legal relationships of the three parties to the surety contract by the elimination of one of them. Since these alterations of the contract were made without the approval of the surety and are novations under Georgia law, Continental must be discharged from its obligations under the bond. See *Lowndes Alliance Warehouse Co. v. Greene*, 17 Ga. App. 542, 87 S.E. 826 (1916); *Palmes v. Southern Mechanical Company*, 117 Ga.App. 672, 161 S.E.2d 413 (1968).

In addition, it is unmistakable that Winston failed to comply with the default provisions as set forth in Article 22 of the contract. The surety bond between Continental and Diversified incorporated the provisions of Article 22 which, by its express terms, provided that the surety was entitled to seven days written notice prior to a declaration of default.

It is conceded that this notice was never given to the surety. Winston did, of course, consider Diversified to be in legal default of the contract and its actions of April 7th must be interpreted as a functional declaration of the contractor's actual status.

Winston may have had excellent reasons for not complying literally with the default provisions of its contract. Such a declaration of default may well have added additional costs to the already swollen construction budget and jeopardized Winston's permanent financing. In a time of rising interest rates and tighter money markets its failure to abide by the provisions of Article 22 may have made good economic sense. See Record at 211. We do not believe, however, that a party to a contract can pick and choose among its provisions, following those which inure to his benefit and ignoring those which might cause him detriment. On the contrary, a party either chooses to honor a contract or for tactical reasons decides to proceed without its protection.

It is not entirely clear how timely notice pursuant to Article 22 would have advantaged the surety. However, it is conceivable that had Winston, in April, 1969, placed Diversified in default in a manner consistent with Article 22, Continental might have negotiated a settlement of its liability or the surety could have taken

steps to decrease, or fix or mitigate its duties under the bond. It is, of course, possible that Continental would have denied any responsibility to Winston on the grounds that the project was not commenced in a timely manner, or that the term of the bond had expired or for any other reason.[5] The Court has no way of knowing what the surety's public legal response, as distinct from the private suggestions of its servants, would have been had Winston properly declared the contract in default. Since Winston declined to assume the immediate economic risks inherent in declaring default, pursuant to Article 22, it failed to properly shift Diversified's contractual obligations to the surety.

Nor do we agree with Winston's contentions that a declaration of default would have increased its risks unreasonably. Even if the surety had, following proper notice of default, formally denied liability under the bond, Winston had the right, by the plain terms of Article 22, to take control of the construction site and the contractor's equipment within seven days of that

[5]We note as to the issue of term that Continental agreed to bond a construction project which was to be completed in three hundred days. In fact, the nursing home took in excess of six hundred days to complete, or more than double the specified term of the bond. Continental does not argue that the term provisions of the bond of a compensated surety are absolute. See *Restatement of Security*, Sec. 129(2). It is, however, possible that Winston may have waived its rights under the bond by failing to declare default within a reasonable time after it became obvious that Diversified would be unable to satisfy its obligations under the construction contract. In light of the facts of the present case, it is not necessary that the Court reach and resolve this question of law.

notice. The principle of mitigation may well have required, and would certainly not have prevented Winston from proceeding as it in fact did under the contract of April 7th. If the surety had refused to negotiate on the grounds that it had been discharged by earlier acts of either Winston or Diversified, the plaintiff's equitable and legal standing, in regard to subsequent litigation, would have remained unsullied.

Even if we were to assume, *arguendo*, that timely notice of default would not have been beneficial to the surety, Winston was bound by its contractual obligations to give it in any event. It cannot be exonerated for not having done so on the ground that strict compliance with its contractual obligations may have resulted in economic injury. Winston elected not to proceed on its contract and will not now be heard to say that that same contract now affords it a remedy.

Under Georgia law, a "contract of suretyship must be strictly construed in the interest of the surety." *Peara v. Atlanta Newspapers, Inc.*, 120 Ga.App. 163, 169 S.E.2d 670 (1969); also see *Glasser v. Decatur Lumber & Supply Company*, 95 Ga.App. 665, 99 S.E.2d 330 (1950); *Maryland Casualty Co. v. McAlpin*, 31 Ga.App. 330, 120 S.E. 644. The courts of that state have further noted that: "[T]he undertaking of a surety being stricti-juris, he cannot, in law or equity, be bound further than the very terms of his contract." *Mayor of Savannah v. Glen Falls Insurance Co.*, 104 Ga.App. 879, 123 S.E.2d 293 (1961); also see *Peara v. Atlantic Newspapers, Inc., supra*, 169 S.E.2d at 671; *Glen Falls Insurance Co. v. Wright Contracting Co.*, 276 F.Supp.

122, 131 (D. Md. 1965) (under Maryland law.)[6] For all of the foregoing reasons the Court does not believe that Winston's claims under the bond are meritorious.

Winston also asserts as a basis for recovery against the defendant, in addition to its claim on the bond, a common law theory in both contract and tort. It argues that Continental's acts, which included a failure to disclose information regarding Diversified's financial status and a refusal to reveal in advance of claim several potential defenses to the bond, constituted a violation of the duty of good faith owing from a surety to its obligee. Plaintiff places primary reliance for these contentions in the doctrine of *Trinity Universal Insurance Company v. Gould*, 258 F.2d 883 (C.A.10 1958) (under Kansas law).

We do not believe that *Trinity* can be reconciled with accepted principles of Georgia surety law. As we have noted above, contracts of surety in Georgia must be "... strictly construed in the interest of the surety." *Peara v. Atlanta Newspapers, supra*, and other cases

[6]The plaintiff argues that under the holding of *Peachtree Roxboro Corp. v. United States Casualty Co., supra*, it was under no absolute requirement to give notice of Diversified's default to the surety. This is certainly true as far as it goes but we do not believe the *Peachtree* principle is controlling in the instant case. The bond under litigation in *Peachtree*, unlike the one at bar, did not require "... notice of any default to be given by the plaintiff." *Peachtree Roxboro v. United States Casualty Co., supra*, 114 S.E.2d at 53. The case law of Georgia clearly establishes that there is no absolute duty to give the surety notice of a major default by the contractor absent a contractual obligation to do so. We note, only in passing, that this view is not inconsistent with the view prevailing in this Circuit. See *United States v. Ohio Casualty Insurance Co.*, 399 F.2d 387 (C.A.6 1968).

cited at 11. A duty of good faith may well be imposed upon any party to a surety contract but it cannot extend to relieve the obligee of duties and responsibilities which properly repose in him. Strict compliance with the provisions of Article 22 by Winston was a condition precedent to Continental's liabilities, if any, under the bond. There is no way of ascertaining whether the surety would have met its duty of good faith under the bond, informal memos of its agents notwithstanding, as the condition precedent to that duty was never properly discharged.

Nor does this Court believe that any obligation devolved upon Continental to inform Winston of Diversified's economic straits. This information was ascertainable upon reasonable investigation and soon after construction began it was obvious to both the surety and the obligee that Diversified was incapable of proceeding in an acceptable manner under the contract. In the usual course, the converse of the position urged by plaintiff upon the Court is true. Since the obligee contracts initially with the principal, it often does so following an investigation. In the course of that investigation it may discover information regarding the principal which tends to affect the surety's risk and which is kept from the surety's attention. In these situations the general rule and the one in force in this Circuit is that the obligee is under no duty to disclose this information. See *United States v. Ohio Casualty Insurance Co., supra*, 399 F.2d at 389; *Magee v. Manhattan Life Insurance Co.*, 92 U.S. 93 (1876). We can perceive no reason why a different rule should be imposed where the surety possesses information accessible to, and indirectly known by, the obligee. Once

Winston knew that Diversified, for whatever reason, would be unable to meet the requirement of the contract, it had the option of placing the principal in default but it failed to exercise this right. Plaintiff's ultimate harm was not, therefore, a consequence of Continental's failure to disclose.

Several other issues have been advanced and briefed by the parties, but finding as we have above, it becomes unnecessary to reach these.

The foregoing shall constitute our findings of fact and conclusions of law as required by Rule 52, Fed. R. Civ. P.

Accordingly, on the basis of the evidence and for the reasons and authorities as set forth above, judgment shall be entered in favor of defendant Continental Casualty Company and against plaintiff Winston Corporation.

It is so ORDERED.

/s/ Carl B. Rubin
United States District Judge

IN THE
DISTRICT COURT OF THE UNITED STATES
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

FILED
John D Lyter, Clerk
June 20 422 PM '73

U.S. District Court
Southern Dist. Ohio
East. Div. Columbus

The Winston Corporation,
Plaintiff,

v. Civil No. 70-179

Continental Casualty Company,
Defendant.

ORDER

This matter comes before the Court on plaintiff Winston Corporation's motion, pursuant to Rule 59(e), Fed. R. Civ. P., for a reconsideration of our Opinion and Order of March 2, 1973, as finalized by Judgment March 13, 1973.

In our view the factual and legal issues presented in this case were fully discussed and resolved by our earlier Order and will not be repeated here. It must be kept in mind that in this diversity action, under applicable principles of conflict of laws, we sit as a Georgia court, applying the law of Georgia as it would be applied by a judge of that state. This we have tried

to do and the conclusions of our legal research are set forth in our Opinion of March 2, 1973.

Under these circumstances we would deem it inappropriate to attempt to graft the perhaps more enlightended or liberalized views of other jurisdictions, see, for example, *Trinity Universal Insurance Company v. Gould*, 258 F. 2d 883 (C.A. 10 1958) upon what we deem to represent settled principles of the jurisprudence of Georgia. As we noted in our earlier Opinion, a different result may well have obtained under Ohio surety law. See *Id.*, at 7 (slip opinion). Had the parties at the time they negotiated their contract included a "forum-selection" clause, wherein it was provided that the law of Ohio or some other state, would govern the resolution of any disputes under the contract, this Court would have, in all likelihood, honored such a provision. See *M/S Bremen vs. Zapata Off-Shore Co.*, 407 U.S. 1(1972). Since the parties failed to do this strict Georgia law of suretyship, which makes relatively little differentiation between compensated and uncompensated sureties, is a bar to plaintiff's recovery.

Nor do we think it appropriate to write what may be our own personal views of what is correct upon the surety law of Georgia. A functioning system of law, as contrasted with one of men, at times demands that the personal beliefs or caprices of individual judges be subordinated to established principles of law. If the surety law of Georgia is out of joint, surely it is for the legislature and the judges of that state, who have continuous contacts with the purported problems, and not for this Court, whose contact is fortuitous, to set it right.

Accordingly, plaintiff's motion for reconsideration is without merit and the same is hereby DENIED. The judgment of March 13, 1973 is, therefore, REINSTATED.

It is so ORDERED.

/s/ Carl B. Rubin
United States District Judge

APPENDIX C

No. 73-1886
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

FILED
APR 2 1975
JOHN P. HEHMAN, Clerk

THE WINSTON CORPORATION,
Plaintiff-Appellant

- vs - ORDER

CONTINENTAL CASUALTY COMPANY,
Defendant-Appellee

BEFORE: WEICK and MC CREE, Circuit Judges, and CONTIE,* District Judge.

A petition for rehearing with suggestion for a rehearing en banc having come on to be heard and the suggestion for a rehearing en banc not having been adopted, upon consideration, it is ORDERED that the petition be, and it hereby is, DENIED.

Entered by order of the court

/s/John P. Helman
Clerk

*The Honorable Leroy J. Contie, Judge, United States District Court for the Northern District of Ohio, sitting by designation.

APPENDIX D

FILED
JOHN D. LYTER, CLERK
APR 28 11 18 AM '75
U.S. DISTRICT COURT
SOUTHERN DIST. OHIO
EAST. DIV. COLUMBUS

FILED
JAN 17 1975
JOHN P. HEHMAN, Clerk

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 73-1886

THE WINSTON CORPORATION,
Plaintiff-Appellant,

v.

CONTINENTAL CASUALTY COMPANY,
Defendant-Appellee.

Before: WEICK and McCree, Circuit Judges, and CONTIE, District Judge.

JUDGMENT

APPEAL from the United States District Court for the Southern District of Ohio.

THIS CAUSE came on to be heard on the record from the United States District Court for the Southern District of Ohio and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby reversed and remanded for entry of judgment for appellant.

It is further ordered that Plaintiff-Appellant recover from Defendant-Appellee, the costs on appeal, as itemized below, and that execution therefor issue out of said District Court.

ENTERED BY ORDER OF THE COUR

/s/John P. Hehman

Clerk

A True Copy.
Attest:

/s/John P. Hehman
John P. Hehman, Clerk

Issued as Mandate: April 15, 1975

COSTS: To be recovered by Appellant

Filing fee	$ 25.00
Printing	$491.20
Total	$516.20